



Report of the auditor-general to the North West provincial legislature and the council on the City of Matlosana

Report on the audit of the financial statements

Qualified opinion

1. I have audited the financial statements of the City of Matlosana set out on pages XX to XX, which comprise of the statement of financial position as at 30 June 2017, and the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the possible effects of the matter described in the basis for qualified opinion section of my report, the financial statements present fairly, in all material respects, the financial position of the City of Matlosana as at 30 June 2017, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP), the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2016 (Act No. 3 of 2016) (DoRA).

Basis for qualified opinion

Irregular expenditure

3. Section 125 of the MFMA requires the disclosure of irregular expenditure incurred. The municipality made payments of R22 005 571 (2016: R40 744 985) in contravention of the supply chain management regulations, that were not included in the irregular expenditure disclosed. As the municipality did not quantify the full extent of the irregular expenditure, it was impracticable to determine the resultant understatement of irregular expenditure of R2 392 320 044 (2016: R2 117 068 158) as per note 44 to the financial statements.

Context for the opinion

4. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of my report.
5. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' Code of ethics for professional accountants (IESBA code) together with the ethical requirements that are relevant to my audit. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.

6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Material uncertainty related to going concern

7. I draw attention to the matter below. My opinion is not modified in respect of this matter.
8. The statement of financial performance indicates that the municipality incurred a deficit of R307 260 510 during the year ended 30 June 2017 and, as of that date, the municipality's current liabilities exceeded its current assets by R307 793 437. These conditions, along with other matters as set forth in note 40, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

Emphasis of matters

9. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unauthorised and fruitless and wasteful expenditure

10. As disclosed in note 42 to the financial statements, unauthorised expenditure of R184 080 291 was incurred in the current year and the unauthorised expenditure of R1 498 231 982 in respect of prior years had not yet been dealt with in accordance with section 32 of the MFMA.
11. As disclosed in note 43 to the financial statements, fruitless and wasteful expenditure of R37 420 124 was incurred in the current year and fruitless and wasteful from prior years of R114 486 490 had not yet been dealt with in accordance with section 32 of the MFMA.

Material losses

12. As disclosed in note 33 to the financial statements, electricity losses of 24% (2016: 25%) with a calculated cost of R125 446 243 (2016: R131 004 821) and water losses of 35% (2016: 29%) with a calculated cost of R86 088 141 (2016: R68 244 392) were incurred.
13. As disclosed in note 27 to the financial statements, contribution to debt impairment provision of R543 458 552 (2016: R480 063 289) were incurred as a result of significant impairment of debtors.

Restatement of corresponding figures

14. As disclosed in note 38 to the financial statements, a number of corresponding figures have been restated as a result of errors discovered during the year ended 30 June 2017.

Material underspending of the budget

15. As disclosed in the statement of comparison of budget and actual amounts the municipality underspent on capital expenditure by R31 693 235 as well as repairs and maintenance by R18 891 075 due to cash flow shortages. As a consequence, the municipality was unable to adequately fulfil its mandate regarding service delivery.

Other matters

16. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited disclosure notes

17. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Unaudited supplementary schedules

18. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

Responsibilities of the accounting officer for the financial statements

19. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA standards of GRAP and the requirements of the MFMA and the DoRA and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
20. In preparing the financial statements, the accounting officer is responsible for assessing the municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless there is an intention either to liquidate the municipality or to cease operations, or there is no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

21. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
22. A further description of my responsibilities for the audit of the financial statements is included in the annexure to the auditor's report.

Report on the audit of the annual performance report

Introduction and scope

23. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected key performance areas presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
24. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
25. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected key performance areas presented in the annual performance report of the municipality for the year ended 30 June 2017:

Key performance area	Pages in the annual performance report
KPA 1 - Basic service delivery and infrastructure development	XX – XX
KPA 3 - Local economic development	XX – XX

26. I performed procedures to determine whether the reported performance information was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
27. I did not identify any material findings on the usefulness and reliability of the reported performance information on any of the selected key performance areas of the municipality.

Other matters

28. I draw attention to the matters below.

Achievement of planned targets

29. Refer to the annual performance report on pages XX to XX for information on the achievement of planned targets for the year.

Adjustment of material misstatements

30. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of KPA 1 - Basic service delivery and infrastructure development as well as KPA 3 - Local economic development. As management subsequently corrected the misstatements, I did not report any material findings on the usefulness and reliability of the reported performance information.

Report on audit of compliance with legislation

Introduction and scope

31. In accordance with the PAA and the general notice issued in terms thereof I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
32. The material findings in respect of the compliance criteria for the applicable subject matters are as follows:

Consequence management

33. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) and (b) of the MFMA.
34. Allegations of financial misconduct against the accounting officer of the municipality were not always investigated, as required by section 171(4) of MFMA.

Budgets

35. Reasonable steps were not taken to prevent unauthorised expenditure of R184 080 291, as disclosed in note 42 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was due to overspending of the budget

that was caused by insufficient budgeting for the impairment on the consumer and other debtors.

Annual financial statements

36. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

Expenditure management

37. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
38. Effective steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the irregular expenditure incurred as indicated in the basis for qualification paragraph. The majority of the disclosed irregular expenditure was caused by deviating from and not following the correct competitive bidding process. Irregular expenditure of R12 394 261 was incurred on the key projects for the construction of water supply from Midvaal end point to Jouberton and Alabama as well as on the Alabama 2ML elevated reservoir.
39. Effective steps were not taken to prevent fruitless and wasteful expenditure of R37 420 124, as disclosed in note 43 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by interest and penalties charged on late payment to creditors.

Procurement and contract management

40. Some of the goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(a) and (c). Similar non-compliance was also reported in the prior year.
41. Some of the contracts and quotations were accepted from bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c). Similar non-compliance was also reported in the prior year.
42. Quotations and some contracts were accepted from bidders whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43. Similar non-compliance was also reported in the prior year.
43. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1). Similar non-compliance was also reported in the prior year.
44. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
45. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality as required by SCM regulation 28(2). This non-compliance was also identified in the procurement processes for the construction of water supply from Midvaal end point to Jouberton and Alabama.
46. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding, as required by SCM regulations 21(b) and 28(1)(a).

47. Competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with SCM regulation 29(2). This non-compliance was also identified in the procurement processes for the construction of water supply from Midvaal end point to Jouberton and Alabama.
48. Some of the contracts were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b). Similar non-compliance was also reported in the prior year.
49. Bid documentation for procurement of commodities designated for local content and production, did not stipulate the minimum threshold for local production and content as required by Preferential Procurement Regulation 9(1).
50. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM regulation 5.
51. Sufficient appropriate audit evidence could not be obtained that the performance of some of the contractors or providers was monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
52. Sufficient appropriate audit evidence could not be obtained that the contract performance and monitoring measures and methods were sufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA.
53. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, in contravention of SCM regulation 46(2)(e) and the code of conduct for staff members issued in terms of the Municipal Systems Act, 2000 (Act 32 of 2000) (MSA).

Human resource management

54. Appropriate systems and procedures to monitor, measure and evaluate performance of staff were not developed and adopted as required by section 67(1)(d) of the MSA.

Other information

55. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report thereon and those selected key performance areas presented in the annual performance report that have been specifically reported on in the auditor's report.
56. My opinion and findings do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
57. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected key performance areas presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
58. I did not receive the other information prior to the date of the auditor's report. When I do receive this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to re-issue my auditor's report amended as appropriate.

Internal control deficiencies

59. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the performance report and the findings on compliance with legislation included in this report.

- Leadership did not adequately monitor management action plans to address prior year audit findings regarding financial and performance reporting, compliance as well as related internal controls. Although there were resolutions adopted by council to address prior year audit findings, the implementation thereof was mostly done through consultants with limited transfer of skills to own staff.
- Effective human resource management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored, was not implemented. An effective organisational structure for placing appropriately skilled people is not in place. There was a lack of continuity in key management positions due to resignations, leading to these positions being filled by acting officials.
- Management's failure to comply with laws and regulations as well as their inability to implement controls to ensure reliable and accurate financial and performance reporting, is a concern. This factor, as well as the continuous non adherence with the council's supply chain management policy without consequences reflects negatively on management's commitment towards a clean administration.
- Management do not have an adequate risk strategy that addresses identified risks in supply chain management, as well as non-compliance with laws and regulations.
- The effectiveness of the audit committee and internal audit's role as an assurance provider was compromised by management's inability to adequately address and react to internal audit's findings and recommendations mainly due to the lack of capacity at senior management level within the municipality.

Other reports

60. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.

Investigations

61. A consulting firm is performing an investigation at the request of the Premier of the North West province. The investigation was initiated during 2015 based on allegations of possible financial misconduct at the municipality. The investigation is still on-going at date of this report.

Auditor General

Potchefstroom

30 November 2017



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected key performance areas and on the municipality’s compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in the auditor’s report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality’s internal control.
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.
 - conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the City of Matlosana ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of the auditor’s report. However, future events or conditions may cause a municipality to cease to continue as a going concern.
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and here applicable, related safeguards.